No. 15912

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CONTINENTAL TRADING, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

REPLY BRIEF FOR THE PETITIONER

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FILED

AUG - 2 1958

PAUL P. O'BRIEN, CLERK

INDEX

Page

Preliminary Statement 1

Reply to Respondent's Argument I:

Respondent Has Not Shown That the Tax Court Correctly Held That The Taxpayer Was Not Engaged in Trade or Business Within the United States During The Taxable Years 2

Reply to Respondent's Argument II:

The Respondent Has Not Shown That the Tax Court Did Not Abuse Its Discretion By Refusing to Relieve Petitioner of its Judgment .. 10

Conclusion 13

Cases

Herbert v. *Riddell* (D.C. Cal., 1952) 103 F. Supp. 369 10

LaGreide, Anders I. (1954) 23 T. C. 508 3

Scottish-American Investment Co. (1942) 47 B.T.A. 474, Affirmed (CCA-4, 1943) 139 F. (2d) 418; affirmed 323 U.S. 119 10

Section Seven Corp. v. *Anglim* (CCA-9, 1943) 136 F. (2d) 155 3

Yerburgh, Est. of Francis S., T. C. Memo Op., Docket No. 6367, entered December 27, 1945 3

Statutes

Internal Revenue Code of 1939:

Sec. 231(b) 5

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Preliminary Statement

Petitioner's Brief was filed in this Court on June 18, 1958. Brief for the Respondent was received by petitioner on July 16, 1958. Under Rule 18, subsection 4, petitioner has until August 5, 1958 within which to file this Reply Brief. The argument in this case has been set for Friday, September 12, 1958.

REPLY TO RESPONDENT'S ARGUMENT I

Respondent Has Not Shown That the Tax Court Correctly Held That the Taxpayer Was Not Engaged in Trade or Business Within the United States During the Taxable Years.

In the introduction to respondent's Argument I it is asserted that the Tax Court viewed all of the petitioner's transactions "as a whole". See page 13 of respondent's Brief. This assertion is made in denial of the petitioner's contention that the Tax Court followed a piecemeal and fragmentary approach in deciding the case. Petitioner does not deny that the Tax Court *said* that it was viewing the Record as a whole, but petitioner does deny that the Tax Court did view the Record as a whole. If it be found that the Court below did take the "whole" view, then it is asserted that this was done in an improper manner. Petitioner submits that a reading of the Tax Court's opinion requires the conclusion that the Tax Court—despite its protestation—adopted the separate transaction or "fagot" approach. The respondent's denial cannot conceal this fact.

A. *Both the respondent and the Tax Court misapplied the applicable legal principles.*

Respondent first attempts to articulate certain general principles applicable in the area of the present controversy. Thus, he states that the Courts have defined "business" to be, "that which occupies the time, attention and labor of men for the purpose of livelihood or profit." Respondent then postulates that "carrying on or doing business" means that a corporation "was organized for profit and was doing what it was principally organized to do in order to realize profit." A number of authorities are cited in support of

these very general propositions which are not challenged by the petitioner. Respondent goes on to state that the latter test, to be applied in determining whether a corporation is engaged in a trade or business, has both quantitative and qualitative aspects.

It is necessary to point out, however, as the cases cited by the respondent themselves demonstrate, that the quantitative aspect is of much less significance than the qualitative one. Indeed, a number of Courts, including this Court, have concluded that a very slight degree of activity is sufficient for this purpose. See *Section Seven Corporation* v. *Anglim* (CCA-9, 1943) 136 F. (2d) 155. In addition, a number of the favorable cases involve decisions bordering upon a *de minimis* activity situation. Cf. *Anders I. LaGreide* (1954) 23 T.C. 508 and *Est. of Frances S. Yerburgh,* T. C. Memo. Op., Docket No. 6367, entered December 27, 1945.

The respondent then makes the point that isolated transactions unrelated to the purpose of the corporation as set forth in its charter or which have no relationship to the general pursuit of profit and gain, do not constitute engaging in trade or business.

Petitioner is in general agreement with this proposition of law but asserts that factually it does not apply here. See discussion *infra.* Indeed, it is but a paraphrase of the loaded statement of the issue framed by the Tax Court (R. 52) as follows:

> "Transactions which are not entered into for profit and which do not and in all probability cannot result in a profit, particularly where such transactions are of an isolated and non-continuous nature, will not dictate the conclusion that one is engaged in business. And that, notwithstanding petitioner's categorical statement to the contrary in its brief, we view as the only issue."

There is scarcely any room for doubt as to the answer to such an issue couched in such terms and this may serve to indicate the attitude of the Court below. Moreover, it places in clear perspective the fact that the Court *was not viewing the integrated picture of petitioner's United States activities as a whole.* The proposition could not have been worded in such fashion if *all* activities were being considered. Obviously, certain selected transactions were in mind to produce such a one-sided and distorted statement.

That this was so is demonstrated by the Tax Court's statement that (R. 53):

> "The detailed analysis submitted by petitioner of all of its transactions during the years in controversy shows that only items accounting for a fraction of 1 per cent of petitioner's total income represent those which by any stretch of the imagination could be considered business."

No attempt is made at this point to refute the statement (but see *infra*), however, it is submitted that this shows that the lower Court has excluded from consideration over 99 percent of petitioner's income-producing activities as being non-business. This, petitioner says, is legal error. The *ensemble* of *all* of petitioner's activities viewed as a whole could constitute "engaging in a business" even supposing that some of these separate activities would not. But the Tax Court has failed to consider the ninety and nine and has found the one a sham.

The respondent also concludes that it cannot be charged that there was any clearcut mistake of law made by the Tax Court below. With this position the petitioner is in diametric opposition. As set forth in Argument I of Petitioner's Opening Brief, the Tax Court did err as a matter of law in reaching the conclusion it did. Among the legal errors there mentioned were the following: (a) failure of

the Tax Court to take into account the composite picture of all of petitioner's United States activities; (b) failure of the Tax Court to recognize that petitioner was doing or attempting to do what it had been organized to do; (c) the Tax Court's reliance upon the fact that *some* of petitioner's activities produced little or no profit; (d) the improper emphasis which the Tax Court erroneously placed upon the alleged low *quantum* of activities of petitioner; (e) the failure of the Tax Court to place any legal weight upon the "can" transactions, even after conceding that they were transactions of "substance"; (f) the significance attached by the Tax Court to petitioner's alleged lack of business purpose and tax-savings motive; and (g) the Tax Court's failure to find all of the relevant and material facts from the record.

Respondent has failed to meet or even discuss most of these asserted errors either directly or indirectly. The fact that the respondent does not challenge some of the asserted legal errors committed by the Court below of itself should suffice to warrant a reversal. It also permits the conclusion that respondent has misapplied the correct legal principles.

B. *Both the respondent and the Tax Court have misconstrued and misapplied the facts.*

The respondent here endorses the position taken by the Tax Court below that Section 231(b) of the Internal Revenue Code of 1939 was not intended by Congress to apply in the case of a foreign corporation "merely servicing its investments in this country". (See R. 53 and respondent's Brief page 19.) Despite the fact that the Tax Court attributes the quoted language to "an unequivocal statement" appearing in connection with the enactment of the 1942 Amendment, petitioner is unable to identify the precise language quoted in the Committee Reports and concludes that the words used are not words of art. But even assum-

ing that these words reflect the true Congressional intent, it is submitted that the petitioner's activities were far more than "merely" servicing its investments. Even if it be deemed that the receipt of Servel and Electrolux dividends aggregating over $1,800,000 in the three taxable years and the sale of 55,000 shares of Servel stock constituted "servicing investments" certainly none of the petitioner's other activities would fall in such a category. With the *caveat* that even the activity of "merely servicing investments" would be one of the factors to be taken into account when viewing the composite activities of the petitioner as a whole, petitioner points out that it had many other activities during the taxable years.

Petitioner's "time, attention and labor" were occupied during the taxable years in such other activities as drawing 199 checks on two bank accounts in a total amount of some four million dollars, negotiating seven bank loans aggregating over $6,800,000 and repaying a considerable portion of such loans together with interest, purchasing equipment as an accommodation for a foreign corporation, purchasing and reselling a freight carload of fat, purchasing and reselling 91 freight carloads of tin cans and, most important, negotiating in the United States and abroad with respect to the petitioner's program for financing and erecting recombined milk plants. That all these activities as well as the "servicing" activities consumed time, attention and labor is evidenced by the not insignificant office expenses incurred in California for items such as telephone, telegraph, legal, travel, postage, printing and insurance.

Respondent asserts (p. 22) that none of petitioner's activities, aside from the collection of dividends, relate in any substantial way to any of the purposes for which taxpayer was "mainly" created or to the motive of profit. As indicated in the corporate charter, the purposes for which the petitioner was formed were quite broad and

there is no difficulty in relating the various activities of petitioner with authorizing provisions in the charter. Selling stocks is specifically mentioned as is the holding of stocks. The same is true as to buying, selling, distributing and dealing in milk and milk products. Comparably, the purchase and sale of tin cans designed to hold milk powder is ''dealing in supplies * * * used in connection with * * * milk and milk products''. The charter likewise authorizes the purchase and sale of machinery as well as ''articles'', which would cover fat. The usual powers of any corporation would warrant petitioner obtaining bank loans. In short, everything that petitioner did in the United States during the taxable years was an authorized act.

It should be pointed out that the petitioner had been organized, as the previous discussion of the corporate charter provisions indicate, to engage in a wide range of activities. Among these activities and undoubtedly an important activity, was the authorization to deal in milk and all kinds of milk products and related matters. The Record shows that petitioner, principally through its president, Turnbow, made repeated efforts which consumed time, attention and labor, to consummate the milk program. In this connection negotiations took place both in the United States and abroad. This point has been discussed in petitioner's opening Brief and need not be repeated here except to indicate the incorrectness of the Tax Court's finding espoused by the respondent on page 23 to the effect that, ''Not only did taxpayer never undertake any activity in connection with the establishment of * * * recombined milk plants * * *'' but * * * ''never used its assets and borrowings for this or any related purposes.''

Turning to the consideration of the Tax Court's and the respondent's assertion that all of petitioner's transactions were either isolated and non-continuous or were not entered into with a reasonable expectation of profit,

the Record will disclose again the error of the position.

It is conceded that the purchase and resale of the freight carload of fat and the accommodation purchase of equipment for a foreign corporation were both isolated and non-continuous transactions. In contrast, the other transactions involved were not of that category, involving activity, scope and continuity. This would include drawing 199 checks, negotiating 7 bank loans, the several sales of Servel stock, the purchase and resale of 91 freight carloads of tin cans, the continuous negotiations here and abroad concerning the erection of recombined milk plants and the receipt of dividends.

So far as the profit motive is concerned it is also conceded that no profit was expected or could be derived from the mere act of drawing checks. The same thing may be admitted with respect to negotiating and repaying bank loans and interest thereon, making the accommodation purchase of equipment for a foreign corporation and the act of incurring various miscellaneous office expenses in Oakland, California. But even these actions indirectly bear on other activities which do involve profits. On the other hand, profit was the direct motive behind: the receipt of the dividends, the sale of the Servel shares, purchase of the carload of fat, the purchase and resale of 91 freight carloads of tin cans, obtaining bank loans, and the negotiations here and abroad concerning the development of the recombined milk program. (Unfortunately, the Record contains no reference to the non-United States activities of petitioner—its extensive Mexican activities and large number of operating subsidiaries there—which would serve to place in perspective some of its United States activities.)

It must be emphasized that the foregoing discussion is based upon a fragmentary or separate transaction approach and not upon the correct method of viewing the entire activity of the taxpayer. The correct viewpoint

recognizes the entirety of the taxpayer's activities, whether or not they are all tinged with the profit motive and regardless of the fact that some may be isolated or non-continuous. To state the proposition differently, a number of unrelated transactions which are isolated and non-continuous can, in the aggregate, be combined with other regular and continuous profit activity so as to constitute all together enough activity, qualitatively, to be a trade or business.

A word must be said with respect to the can transactions which even the Tax Court admitted had "substance". The Court felt that while substantive and real, the can transactions "resulted in no substantial gain, and considering the time spent on them could not, and in several instances actually did not, result in even a nominal net profit," (R. 53). It has already been pointed out that the absence of substantial gain as a matter of law is of no consequence in this case, and the amount of time spent upon these transactions would appear to be immaterial in view of all the other activities of the taxpayer. The alleged absence of even a nominal profit—although this is not so—is likewise irrelevant. Finally, it may be noted that three of the 91 can transactions inovlved sales of cans to a wholly unrelated third party, Farmers Co-Op Creamery, McMinnville, Oregon. See Ex. XXXVII to the Stipulation of Facts.

To characterize—as the respondent does on page 19 of its brief—the taxpayer's activities (other than the collection of dividends) as "little more than a tax-saving-motivated attempt to qualify the collection of dividends as business activity" is to obscure the issue with a false scent. The motive of tax-saving [1] is irrelevant in the present case as

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[1] This preoccupation with "tax-savings" is also evidenced by the Tax Court in its opinion where one of the two factual reasons given by the Court below for its holding was that petitioner's conduct, as apparently admitted by petitioner, was dictated, not by a business objective but

demonstrated by *Herbert* v. *Riddell* (DC, Cal., 1952) 103 F. Supp. 369, and *Scottish-American Investment Co.* (1942) 47 B.T.A. 474, affirmed (CCA-4, 1943) 139 F. (2d) 418, affirmed 323 U.S. 119.

For the reasons set forth in petitioner's Brief and the failure of respondent in its Brief to show any valid reasons to the contrary, as demonstrated above, it is submitted that as a matter of fact petitioner was engaged in trade or business within the United States during the taxable years.

REPLY TO RESPONDENT'S ARGUMENT II

The Respondent Has Not Shown That the Tax Court Did Not Abuse Its Discretion by Refusing to Relieve Petitioner of Its Judgment.

The purported basis for the respondent's position here is to avoid multiplicity of trials as well as the established policy against piecemeal review of cases. But multiplicity of trials is not an onerous burden where justice is involved. Moreover, had the Tax Court granted the motion and permitted a new trial only additional evidence would have been submitted, not evidence in duplication of that already con-

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purely by a desire to save taxes. R. 54 A search for such an express admission has been fruitless. Perhaps the Tax Court was mislead by inartful language appearing in the petitioner's Opening Brief in the Tax Court where, on pages 34 and 35, appears the Argument, "It is immaterial that tax avoidance may have motivated petitioner in engaging in trade or business within the United States." What this argument really meant is indicated at the top of page 35 where it becomes apparent that reference is intended to the favorable tax rate accorded a resident foreign corporation engaged in trade or business as compared with a nonresident foreign corporation. At that point the obviously true statement is made that a foreign corporation deliberately and intentionally can engage in a trade or business in the United States in order to obtain this tax advantage. Whatever may be the reason for the misunderstanding between petitioner and the Court below, the reliance upon absence of business purpose by the Court below and by the respondent here is erroneous.

sidered by the Court. And as to piecemeal review, the purpose of the motion was to avoid that precise problem. If the Tax Court had once definitively passed upon *all* of the available evidence it is possible that there would have been no appellate review. In any event, by denial of the motion the Tax Court itself has created a situation where there conceivably could be piecemeal review of this case, the very thing petitioner sought to avoid.

Respondent's first point is that taxpayer failed to submit with its motion for leave to file any information which might have afforded a possible ground for the granting of the motion. The motion to vacate decision and to reopen is set forth in the Record commencing at page 81 and the attached affidavits of Wenner-Gren and Strid appear in the Record commencing at pages 82 and 84, respectively. Reading these affidavits and the motion together certainly should lead to the conclusion that there was an incomplete and partially inaccurate presentation of facts made in the Tax Court. Moreover, the very references made in the affidavits and the motion were ready to be supported by the sworn testimony which was available to the Court at the time the filing of the motion was argued. It can scarcely be said that the Court below did not have either available to it or offered to it those factual resources necessary to reach some decision with respect to the sense of the motion.

Respondent also expresses grave doubt that the facts proffered during the course of the motion argument showed any substantial basis for vacating the decision; nevertheless, respondent is careful thereafter not to discuss a single one of the proffered points. Instead, respondent contents himself with repeating the semantics of the Tax Court with respect to Wenner-Gren's failure to state that he would have testified had he been called, despite the obvious thrust of his affiadvit and the explanation made by counsel.

The important thing is that under Rule 60 of the *Federal Rules of Civil Procedure,* motions of the kind under discussion are to be given broad and sympathetic interpretation and not a narrow and hypertechnical analysis. The obvious purpose of that rule is to avoid an injustice while it can be remedied. This principle should apply here whether it be deemed that the motion was to be supported on the basis of newly discovered evidence, mistake, inadvertence, or "any other ground" as stated by the Rule.

Petitioner is not unaware of the fact that some Courts have ruled against its contention that the Tax Court should be bound by the *Federal Rules of Civil Procedure.* Petitioner is, however, unable to find any square authority in this Court on the question. Even should this Court conclude that the *Federal Rules* do not apply in the Tax Court then at least it would seem that Rule 60 would supply an admirable standard for comparison in passing upon the question of whether the Tax Court abused its discretion.

It is respectfully submitted that the ends of justice are best served here by remanding this case for further testimony in the Tax Court so that all relevant evidence may be considered.

Conclusion

The decision of the Tax Court is erroneous and should be reversed or at least the case should be remanded for further proceedings.

Respectfully,

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